

10

**PUBLIC CONTROL AND LOW FREIGHT
RATES—THE TWO ESSENTIALS OF
ANY SOLUTION OF THE RAIL-
ROAD PROBLEM.**

LIBRARY OF CONGRESS CARD A19-1510

WILLIAM W. COOK
General Counsel of
The Mackay Companies,
Postal Telegraph-Cable Company,
and Commercial Cable Company.
Author of
“Cook on Corporations.”

THE NEW YORK PUBLIC LIBRARY

ASTOR LENOX AND TILDEN FOUNDATIONS

500 FIFTH AVENUE, NEW YORK, N. Y.

1911

1

1911

***PUBLIC CONTROL AND LOW FREIGHT
RATES—THE TWO ESSENTIALS OF
ANY SOLUTION OF THE RAIL-
ROAD PROBLEM.***

I.

PUBLIC CONTROL.

Who shall control the railroads?

I, says the railroad employe. Don't I make the wheels go 'round? I am 7 per cent. of the population. I am the Plumb plan.

I, says the farmer with his Grange. Don't I grow the grain and meat that feed the world by means of the railroad? I am 33 per cent. of the population.

I, says the manufacturer with his goods that dominate the trade of the world. Without me this nation would be without great cities and high civilization. I am 28 per cent. of the population.

I, says the investor. My number is as the sands of the sea. I already have eighteen billion dollars in and you want a billion a year more. Raise your railroad rates and protect me. I am the Warfield plan.

I, says the capitalist. I am the blood that flows rich and ruby. I built the railroads. I alone can expand them. I have controlled them ever since they first existed. I am but a nominal per cent. of the population, but I alone have the brains, experience, foresight and capacity to control them. Give them back to me.

No, says the public. The control must be public control. You are all selfishly reaching for a grip on the railroads—the arteries and nerves of the industrial, social and political life of the Great Republic. I am the Thomas plan, followed by the Cummins plan and the

Lenroot plan. Public control of a public institution. The railroad employe, the farmer, the manufacturer, the investor and the capitalist shall all be treated on an equal basis, no one of them securing an advantage at the expense of the other, or at the expense of the public.

J. Pierpont Morgan once said, "Without you have control you cannot do anything."

What is "control"? "Control" is the combined power over rates and expenses. Thirty years ago, prior to the Interstate Commerce Act of 1889, the railroad presidents and directors (and their masters, the Wall Street bankers) had that control over both rates and expenses. They misused that control by discriminations, rebates and political use of their power, and so Congress gave control of the rates to the Interstate Commerce Commission and left the railroads to wrestle with the expenses as best they could. This culminated in 1917, when the Commission would not allow proper increases of rates and the railroads could not avoid an enormous increase in expenses. The plan of divided control failed miserably and utterly. It was public control of rates and private control of expenses—an impossible proposition. The railroads broke down and the government took control.

We have tried two kinds of control: First, private control by the railroads themselves, and, second, public control of rates by a Commission and control of expenses by the railroads themselves. Both are discredited. The only thing left is full public control, either by government ownership or something better.

Now government ownership has been discredited by the experience of the past two years, and the question arises, in what other way can full public control be obtained? Various plans have been proposed. Which one will best give public control?

The Thomas plan will certainly give complete public control. It is the oldest plan of all. It proposes five federal regional railroad corporations to acquire the stocks and bonds of the present railroad corporations. It then proposes the formation of a Federal Railroad Board named by the President with the approval of the Senate. That Board is to control all five of these federal regional railroad companies to be organized; control them as to railroad rates, finances, directors, officers and operation. This would not be government ownership, because the *stocks* of the regional railroad corporations would be held and owned by the public. Neither would it be government control, because the Federal Railroad Board once appointed, would not be subject to orders from the executive department, but would be independent the same as the Federal Reserve Board of the banks. It is complete public control without government ownership.

The Cummins bill would *ultimately* give public control.¹ By that bill, if during a period of seven years the

¹Sec. 13 of that bill is such a complete endorsement of the kernel of the Thomas plan, namely, the organization of federal holding companies to acquire the stocks and bonds of existing railroad companies until complete control is obtained, it may well be quoted in full, as follows:

"At the expiration of a period of seven years after the passage of this Act, the Commission and the Board, each being charged with the duties and clothed with the power herein prescribed, shall proceed to the completion of the plan of consolidation hereinbefore set forth. If in any such proposed system complete consolidation has not occurred, it shall then be the duty of the Board to secure the incorporation of a railway company under the provisions of this Act whose capitalization in bonds and capital stock shall not be greater than the value of the properties ascertained by the Commission under the provisions of said Act of March 1, 1913, with such additions thereto as may be necessary on account of enlargements of the properties so to be consolidated. In such cases the Board shall have the power either to initiate the organization of such corporations or to co-operate with others in the organization, to agree with the owners of railway properties or securities

present railroads do not re-incorporate under federal charters and make such consolidations as a "Railway Transportation Board" may, direct, federal regional railroad

upon the valuation of such properties or securities upon the basis of the valuation as determined by the Commission, to provide for the substitution, upon such basis, of securities to be issued by the corporation so organized under this Act for existing securities or for such exchange as may be found convenient or necessary in fully effecting the consolidation and reorganization of the railway properties as herein provided for, to provide, if found necessary or convenient, that the mortgage, trust, or other liens upon existing railway properties, or any part thereof, may remain undisturbed until the maturity of the indebtedness secured thereby, to exercise the right to take any property or properties or any railway security or securities for the public use under the obligation on the part of the United States to make just compensation therefor: Provided, however, That this power shall not be exercised nor any obligation on the part of the United States created until the money with which to pay for said properties or securities has been secured by the negotiation of new securities to be issued by the corporation which is to become the owner of the property or properties under the plan of consolidation or until the Congress of the United States has otherwise provided.

"In exercising this power the Board shall give reasonable notice to the owner or owners of the properties or securities so to be taken and to the Commission. It shall receive evidence and argument and after a full hearing award the just compensation required by the Constitution of the United States. Any party in interest, if dissatisfied with the award, may file a petition to review the same in the District Court of the United States for the district in which the property or some part thereof is located, making the other parties in interest, including the Board, parties defendant; and thereupon the district court shall proceed *de novo* to hear and determine the cause. From the final order of the district court an appeal to the Supreme Court of the United States, as in equity cases, may be prosecuted by any party to the proceedings in the district court. The Board shall have the power, and it shall be its duty, to transfer, by proper instruments in writing, to the corporation which is to own and operate the property or properties or to hold the securities so acquired at the price so fixed, and to utilize the proceeds of the stock or other securities of such corporation in the payment of the compensation so awarded. It shall have the power, subject to the approval of the Commission to make contracts with such existing railway corpora-

corporations are to be organized to proceed to take over the railroads themselves, or the railroad stocks and bonds, by issuing the stocks of the federal regional railroad corporations in exchange for or with which to buy them. The directors of these federal regional railroad corporations are to be from 11 to 15 in number; 2 to be employees, 2 to be appointed by the Board itself, and the remainder chosen by the stockholders.¹ By §6 the Interstate Commerce Commission is to fix railroad rates. To that ex-

tions as will co-operate with the Board in effecting the aforementioned plan of reorganization and as may agree with the Board upon the valuation of their railway properties upon the aforesaid basis, providing for a guaranteed operating income pending the reorganization, whether the reorganization and consolidation shall be carried out under an original incorporation under this Act or a reincorporation of an existing company, and until, with reference to any particular system, the reorganization and consolidation are complete. Provided, however, That in no case shall the guaranty of operating income exceed the compensation authorized in the Act approved March 21, 1918, with due allowance for subsequent additions for betterments and extensions to the property or properties."

The preceding is a long step in advance, inasmuch as if enacted it will at least put into operation this plan of acquiring and controlling all the railroads of the country and at the same time preserving private ownership.

¹Incidentally it is well to remonstrate against such a mongrel board of directors. They never could or would act as a unit, but each would be pulling in a different direction, or pulling not at all. Their interests would be so diversified and conflicting that there would be no persistent and consistent policy carried out. Directors of such a public railroad company should represent the public as a whole, and not particular classes of the public. This plan of directors representing special interests, and particularly in a minority, has been tried and has uniformly failed. The United States Government in granting the old federal charter to the Union Pacific Railroad reserved the right to name five directors, and although its directors included such eminent men as Charles Francis Adams, Mark Hanna, Nathaniel Niles, James F. Wilson, Frederic R. Coudert, Colgate Hoyt, John F. Plummer, E. Ellery Anderson, B. F. Wade, Jesse Spaulding, A. Kountze, Joseph W. Paddock, George G. Haven, Don M. Dickinson, William J. Coombs, Franklin MacVeagh, Fitzhugh Lee and other men well-known between 1864 and 1897, many of whom were army officers during the Civil War and had the training of civil engineers, yet they

tent it is a divided control and not to be commended.

The Lenroot bill is still nearer the Thomas bill. There is to be but one federal railroad corporation, to own or control all the railroads of the United States. The directors are to be 11 in number: 1 an Interstate Commerce Commissioner; 1 named by the State Commissions; 2 to be named by railroad trade unions; 2 named by the Chamber of Commerce of the United States; 2 named by farmer organizations, and 3 elected by the stockholders by mail. This federal railroad corporation is to acquire at least a majority of the capital stock of all of the existing railroad corporations as soon as practicable, by exchange for its own stock or by selling its own stock to obtain the money. Its own stock is not to pay more than 6 per cent. nor less than $3\frac{1}{2}$ per cent. dividends, and the Government is to guarantee 4 per cent. or whatever the maximum dividend is, if less than 4 per cent. No stock is to be issued except with the approval of the Interstate Commerce Commission. The new corporation may receive proxies to vote stock in present railroad corporations, and may vote the stock itself owns. It may condemn the railroads themselves or their stocks and bonds, and the valuation placed by the Commission on a railroad or its securities is to be conclusive, subject to an appeal. The corporation may make railroad rates sufficient to pay expenses and maximum dividends

cut no figure in the management of the Union Pacific Railroad. The road went into the hands of a receiver and was foreclosed. Another instance appears in your record where Mr. Amster stated to you that, although Prof. William Z. Ripley, of Harvard University, Mr. Henry Bruere, Mr. Peter G. Ten Eyck, a former Congressman, and he are four of thirteen directors of the Rock Island, yet the four have but little to say. "We make objections here and there, but it is still in the control of the same class of management that was in control before we fought and won." (Record, p. 346.)

Councils that are divided, not merely in opinion, but in interest, are never effective. It was not until Foch was placed in supreme control of the allied armies in the late war that the war was won.

with 2 per cent. surplus, such rates to be subject to revision by the Commission. This is not full public control, but it approaches it.

The Esch Bill represents the views of the Interstate Commerce Commission. It enlarges the powers of that Commission and does not contemplate a federal corporation or any public control different from the present. The trouble is that Commission control of rates has been weighed in the balance and found wanting. It has wielded power for thirty years and the results have been lamentable. Theoretically, a Commission exercises delegated administrative power, but practically it exercises judicial power and tries cases with pleadings, counsel on each side, sworn witnesses, briefs and elaborate decisions. Now a judicial body is not fitted for executive action. It is deliberative, slow, and confines itself to as few points and precedents as possible. Executive action is prompt, ready to rise to an emergency, peremptory if need be, quickly adopting new means to accomplish results. Hence Commissions fail as to rates. They are too late, too narrow, too little in touch with and responsive to the boundless, throbbing pulsations of the railroad trade of the country. Rates should be fixed by a Federal Railroad Board, appointed by the President, confirmed by the Senate—the best men available, irrespective of their previous occupations. Then if they are made responsible for expenses, by giving them control of the federal corporations which own and operate the railroads, we shall have real responsibility and a unified control, which will be public control with private ownership.

The Plumb plan contemplates control—not by the public, but by the railroad employes. For a brief week, when it was endorsed by labor organizations, the Plumb plan seemed a menace to the country, but public sentiment throughout the country rose rapidly and

vociferously in repudiation and condemnation of the impudent proposition, and sent the Plumb plan into everlasting limbo, beyond the hope of resurrection.

The Warfield plan would again bring back bankers' control, euphemistically called investors' control. There is to be no change in the method of selecting railroad directors and officers. The stockholders are still to go through the farce of electing directors by giving proxies to those who are already in by the grace of Wall Street. The main purpose of the Warfield plan is the protection of capital. Capital *should* be protected, and it will be protected; but the general purpose of this Warfield plan is to divert earnings of prosperous roads to non-prosperous roads. This is an astounding proposition.¹ Have we not outgrown that sort of thing? In the olden times people had a sneaking admiration for Robin Hood, because he robbed the rich to give to the poor, but those good old buccaneering days have gone by, and modern business ethics are supposed to be slightly better.

¹Mr. Sims, of the House Committee, and formerly Chairman, on July 23, 1919, said at the hearing:

"Do you believe it is morally or economically right to take the earnings from one private owner and give them to another private owner because that other private owner does not make as much money as the first—that is, as applied to anything, whether it be a railroad or a farm or anything else?" (Record p. 204.)

In a pamphlet issued June 9, 1919, I said that the constitutionality of the Warfield plan was doubtful, to say the least. In a letter written by me to Mr. Warfield, July 11, 1919, I said: "My view is that if a rate is unreasonable the legislature may reduce it, *so that the shipper may get the benefit of what he is entitled to, namely, a reasonable rate*, but there is no decision holding that legislature may allow an unreasonable rate to continue and then order that the unreasonable part of the rate shall, by legislative fiat, be turned over to some other carrier."

A little later Judge Lovett, in a pamphlet, was very decided in his opinion that the Warfield plan was unconstitutional. He said:

"Another and much advertised and discussed method for solving the problem presented by the existence of financially

An illustration may throw light on the Warfield plan. The Postal Telegraph-Cable Company on August 1st, 1919, reduced the telegraph rate 20%; in other

strong and weak lines in the same locality is, in substance, that the Interstate Commerce Commission shall divide the railroads of the country into territorial or traffic groups and take the 'Property Investment' account or book value of all the railroads in each group and establish rates for that group sufficient to yield, say, six per cent, or some other specified return, on such investment or book value of each group. Undoubtedly this would result in a much higher yield than the average for the efficient roads, and much lower than the average for the inefficient, just as has always been the case in the past. But it is proposed as a part of this plan, that the most efficient roads shall be limited to the average, and their earnings in excess of the average shall be set aside for the benefit, in some form, of the unprofitable roads that earn less. The method of distributing the fund between the different roads varies with the different suggestions, but all contemplate that the law shall limit the earnings of the prosperous roads and increase the earnings of the poor roads. The advocates of the plan may argue that they do not intend to take any value away from the strong roads except those whose earnings are 'excessive,' but that the earnings of the weak roads will be provided by increasing rates under an adjustment that will give all the increase to the weak roads. But many of the roads are already earning in excess of six per cent, the average rate suggested; and obviously the plan proposes to take this excess from the stockholders of the roads earning it for the benefit of the security holders of the weaker roads. However disguised, and in spite of all the refinement of draughtsmanship and legal expression, the substantial object sought is to take, directly or indirectly, from the stockholders of the prosperous roads net earnings of their properties and give the same to the security holders of the weak roads. * * * But I submit that Congress is without power to take the net earnings belonging to the stockholders of one railroad company for the benefit of the security holders of another railroad company. It would be a denial of due process of law and would also be the taking of private property for public use without just compensation, contrary to the Fifth Amendment of the Federal Constitution. *A law that would take the net earnings of one railroad company and give the same to another would be as obnoxious as would be a law declaring that the property of A should thereafter be the property of B.* * * * The Government may say that the carrier is making too much money and may reduce its rates, but I can

words, put the rate down to what it was before Mr. Burleson, as Postmaster-General, raised it. The Western Union has not met the cut. Under the Warfield

imagine no principle upon which it can be claimed that, instead of reducing the rates, the Government may take the money from the carrier that earns it, for the benefit of another carrier, any more than it can take from the miscellaneous funds or assets of the carrier, cash or property, for the benefit of a poorer carrier, in order to equalize their financial conditions."

Judge Lovett's argument is not answered by a reference to the decision of the Supreme Court in *Noble State Bank v. Haskell*, 219 U. S., 104. That case is a far cry from the Warfield plan. In that case the court held that a state might require the banks in that state holding state charters to contribute one per cent. of their deposits toward a fund for the protection of depositors in any of the contributing banks which might become insolvent. The decision is based partly on the right reserved by the state in granting these bank charters to alter or amend them. Certainly the United States Government has not reserved any such right in the railroad charters, and, in fact, the United States Government did not grant these charters, but they were granted by the states, excepting two or three federal charters, which are negligible. In the next place the court in that decision pointed out that the amount taken by this guaranteed fund and actually used was "comparatively insignificant." It will be observed, also, that in that case the money was taken for the protection of third parties—in other words bank depositors, while in the Warfield plan the proposition is to take it from one railroad and practically give it to another railroad. Mr. Thom distinguishes the Haskell case by pointing out that it is based on the tax power and was an occupation tax, as explained in 243 U. S. 245. (Record, p. 1242.)

Mr. Thom, appearing before the House Committee August 26, 1919, stated the above constitutional objections as follows:

"Let us analyze the transaction a little further. If a shipper is required to pay an unreasonably high charge for the service furnished by the carrier, I think all will agree that the excess over a reasonable charge would belong to the shipper, and to no one else. In fact, if it is an unreasonably high charge, not authorized by law, he can recover it through the courts, or through the reparation clauses of the commerce act. It is his, and does not belong to anyone else. The carrier has no right to it, and no third party has any right to it, nor has the public any right to it. It is an amount which has been unjustly exacted from the shipper, and the amount thus unjustly exacted belongs to him.

"If the Government can authorize an extortionate charge then and attempt to make amends by simply transferring the

plan, applied to the telegraphs, the Postal Company would proceed to raise the rate again, probably 20%, but that 20% increase would be largely for the benefit of the Western Union, as a company that cannot compete. A large part, if not all, of the Postal Telegraph Company's increased profit would go into a "revolving fund"

excess to the Public Treasury or to some other railroad, it is doing an inexcusable injustice to the shipper who has been overcharged. If it transfers such excess from a more prosperous road to another railroad, it overcharges one set of shippers for the benefit of the other railroad. If it does not transfer the excess to any other railroad, but simply covers it into the Public Treasury and uses it for general transportation purposes it is itself becoming the beneficiary of the unjustly and unreasonably high charges which it has imposed upon a certain class of shippers. It thus not only has legalized extortion, but has legalized it for its own benefit. There can be no justification either in law or morals for the Government's permitting any unreasonably high charges to be collected from a certain class of shippers, for to do so would be to surrender the fundamental obligation of the Government to the shippers to see that they are not improperly charged." (Record, p. 1240.)

Judge Hughes clinched the argument on this point in an opinion published September 30th, 1919, containing the following:

"Unreasonable rates constitute an unjust exaction from shippers or passengers. The rates maintained by Congress or under its authority in the exercise of its power of regulation of interstate commerce are lawful because deemed to be reasonable, a presumption which the courts entertain, so long as the rates lie within the range of legislative discretion.

"But if we proceed on the assumption that the rates which are actually charged are extortionate, it would appear to be an abuse of the regulating power of Congress to enforce them. Congress, it may be said, could not, under the guise of regulating interstate commerce, compel shippers or passengers to pay confessedly extortionate charges for the services rendered. On the hypothesis that the charges are unreasonable the power to authorize them, no less than the power to collect them, falls. The exaction and maintenance of such charges would deprive shippers and passengers of their property without due process of law.

"An attempt to divest the carrier of any portion of its earnings thus obtained on the theory that the charges which it was reasonable for shippers and passengers to pay for its ser-

for the ultimate benefit, directly or indirectly, of the Western Union. The public would lose the 20% and also lose competition, because why should the Postal

vice it was unreasonable for the carrier to retain would, in my judgment, be outside the scope of appropriate and valid regulation.

"The mere fact that it proposed to devote the moneys or property of a carrier or of any other person to good uses cannot be regarded as justifying the deprivation of the carrier or such person of the right to enjoy and retain his own property, except as it may be taken for proper governmental purposes through valid taxation or for public use on the payment of just compensation."

The Warfield people argue that all railroad rates should be raised to bolster up the weak railroads, and thus preserve the railroad system as a whole. Such preservation can be justified solely on the ground of good service at low rates. Good service will not be promoted by taking from the strong railroads a part of their earnings. Low rates are concededly not to be given, but, on the contrary, the rates are to be higher. In other words, the Warfield plan to preserve the railroad system as a whole, defeats the very purpose of such preservation. Good service at low rates is to be sacrificed for weak railroads, which constitute but a small part of the railroad system. That which is now a reasonably high rate for a shipper to pay, who is living alongside a well located, well built and well managed railroad of established business, is to be made still higher, in order to increase the income of some adjacent crippled railroad in a "group" of railroads, artificially carved out under the Warfield plan.

It is difficult to ascertain just how the Warfield people propose to dispose of the "excess profits." One-third is to be retained by the company earning it, and one-half is to go to labor, but the disposition of the remainder is very indefinite. It is to be consumed "by investment in cars to be owned by the public and to be operated in their sole interest" (Record, p. 1047), or "in the purchase of what are now private cars, or any other facilities of transportation, and operated at cost, thus reducing operating expenses and providing equipment for the weak lines, for the short lines, which now have great difficulty in times of congestion," or is "to be expended in the public interest" (p. 1071); or "in the interest of the shippers" (p. 1668), or "in the interest of the shippers by the purchase of equipment" (p. 1676) thereby giving "better service to the shippers" (p. 1679), or the Interstate Commerce Commission may assist in the conduct of the operations and properties of any railroad "to meet any emergency which may * * * arise" (p. 1072). The following, from p. 1055 of the record, is illuminating: "Under the operation of this

Company seek patronage by good service, if it is to be deprived of the profits from that service? There is no danger of this happening, but it illustrates the workings

plan they are all permitted to pay their customary dividends, and the amounts which are recaptured are obviously from surplus, and unnecessary to sustain the carrier in carrying on its public duties or preserve its credit. One of the most conspicuous instances of excess earnings reduction is the Lackawanna. I believe the reduction of surplus in case of the Lackawanna under this plan would be about one million and a half; but it would still be enabled, as I am definitely advised to pay its customary dividends, and, as you will see upon an analysis of the bill, its credit and its ability to serve the public is literally assured not through any guarantee of rates or returns but through its ability to lay its case before the Interstate Commerce Commission; and if it is necessary it is to be permitted, under rules laid down by the commission, to set up surpluses upon its own books, not to be capitalized for the purposes of rate making or to establish a rate level."

I think on the whole, that Judge Lovett was justified in his statement quoted above as follows:

"However disguised and in spite of all refinement of draughtsmanship and legal expression, the substantial object sought is to take directly or indirectly, from the stockholders of the prosperous roads net earnings of their properties and give the same to the security holders of the weak roads."

The latest revision of the Warfield plan contains the following:

"The remainder of such excess-earnings fund and the usufruct therefrom and accumulations thereof shall constitute a revolving fund, the special property of the United States, to be employed, invested, loaned, or expended by or under the direction and subject to the control of the commission in furtherance of the public interest in railway transportation either by way of loans to carriers subject to this act or by way of purchase, lease, or rental of motive power, cars, or necessary facilities or equipment or otherwise, upon such terms as may be found desirable, to avoid congestion, interruptions, or hindrances to the railway service of the United States by carriers subject to the act to regulate commerce or to further the public service rendered by them." (Record, p. 2837.)

As to giving one-half to labor, labor prefers a fixed wage. Labor takes little interest in profit sharing schemes. Such schemes have generally not turned out well. See Taussig on "Principles of Economics," Chapter 57, pp. 304-409.

Interstate Commerce Commissioner Clark, at a hearing before the House Committee on September 25th, 1919, said:

of the Warfield plan. The Government would take part of the money of the patrons of the Postal Company and use it in some indefinite sort of way for the benefit of the Western Union. That use of the profits of the Postal Company would not be "due process of law." Even the all-sweeping power of taxation would hardly suffice to sustain such a proposition.¹

The Warfield plan and the Plumb plan are equally selfish and indefensible in this respect. Both are class legislation. Moreover, the Warfield plan does not even give public control. It is the old control of railroad rates by a commission, with responsibility for railroad expenses in the railroad's hands.

The Railroad Presidents' plan is boldly a continuation of the old regime. It would again be Wall Street bankers naming the railroad directors and trying to

"It has been suggested that a part of the excess earnings of the prosperous road should be given as a bonus to the employees of that road. I think that this would be an unsound policy and an undesirable practice. The whole trend of affairs has been in the direction of more complete uniformity in the compensation paid to railroad employees, whether they are on weak roads or on strong roads. I believe that to be a sound policy, but if excess earnings of a prosperous road were distributed as a bonus to its employees, those employees would receive compensation in excess of that received by like employees on a competing less prosperous road and the uniformity in their rates of compensation would be disturbed." (Record, p. 2892.)

¹See the protest of Judge Cooley in his *Const. Lim.* (5th ed.) pp. 261-266; and of Judge Dillon, in his *Mun. Corp.* §§18, 278, 313 (5th ed.) to the effect that a state cannot constitutionally authorize municipalities to make gifts to railroads in order to aid in their construction. The Supreme Court, after prolonged litigations, sustained these gifts, but there were strong dissenting opinions. See *R. R. Co. v. County of Otoe*, 16 Wall. 667, where the Chief Justice and Justices Miller and Davis dissented; *Township of Pine Grove v. Talcott*, 19 Wall. 666; where two Justices dissented and one was absent. Even the power of taxation has very decided constitutional limitations. See *County of San Mateo v. Southern Pacific R. R.*, 13 Fed. Rep. 145 where the opinion was by Mr. Justice Field.

keep the railroads solvent, notwithstanding Interstate Commerce Commission regulation of rates. Wall Street control broke down, not in management, but because Wall Street used the railroads to control the Government and industry. The public revolted and punished the railroads, through the Commission refusing to increase railroad rates. The public will not tolerate a return to that kind of control. It is not only dangerous politically and industrially, but the old railroad practices were wolfish. Moreover, every railroad system under the old regime had its own individual separate control, each looking out for its own selfish interests and few for the public interest. A large part of the time and energy of the upper staff of each railroad was devoted to getting business away from competitors, instead of properly handling business already in hand. And there were all kinds of peculiar characteristics of that diversified control; some honest, others dishonest; some cranky, others urbane; some piratical, others public spirited; some wasteful, others economical—all pulling and hauling in every different direction. That kind of control could not last and should not be restored. It is absurd and yet it is called “competition in service.”¹

The wisest adviser that appeared before the House Committee in connection with this subject in my opinion was George W. Anderson of Boston, United States Judge

¹Judge Anderson’s opinion is as follows:

“Mr. Anderson. I do not think there is any initiative in the railroad companies to-day or has been for 20 years.

“The Chairman. Not either in service or in any other way?

“Mr. Anderson. Perhaps my statement was a little broad. I should have, perhaps, conditioned it in this way: I do not think there has been any effective initiative in any of the big railroad companies which has conduced to the general public good. There has been some emulation, and occasionally a little competition has cropped out, but I am satisfied that such competition as has survived the consolidation, which all of the railroad men have been trying to make (in spite of the fact

in the Circuit Court of Appeals, and an Interstate Commerce Commissioner until November, 1918, and formerly a Public Service Commissioner in Massachusetts, and the Trustee appointed by the court in connection with the stock of the Boston & Maine Railroad held by the New Haven Railroad. Certainly Mr. Anderson was well qualified and his statement to the House Committee, although covering only 29 pages, is full of facts, suggestions and creative ideas. He insisted that competition between railroads, even in service, no longer exists and cannot exist. He advocated a single Federal Railroad corporation to own and operate all the railroads of the country. He would have this company issue its stock in exchange for existing railroad stocks which now pay dividends and he would have the Government guarantee dividends on stock issued by this Federal Railroad corporation. Non-dividend paying stock already outstanding he would have this new railroad corporation condemn. He would have this Federal Railroad corporation fix railroad rates subject to the approval of the Interstate Commerce Commission. In all these details his plan is substantially the same as the Thomas plan. The Thomas plan proposes five Federal corporations, but they would all be controlled absolutely by one Federal Railroad Board and that is substantially the same as having one corporation, so far as control is concerned. Extracts from Judge Anderson's memorandum are given in the notes below.¹

that the Sherman Act stands as a threat and perhaps as a barrier across the way), has cost the community a great deal more than it has paid the community." (Record, pp. 1568, 1569.)

¹"Unification of the railroads in one owning and operating company is in my view, fundamentally necessary.

LOW FREIGHT RATES—WHICH ONE OF THE PROPOSED PLANS WILL GIVE THE LOWEST FREIGHT RATES?

Low freight rates are the life blood of the nation. Without them, trade, foreign and domestic, will languish, or else the producer's profits will shrink to the vanishing point. Any plan that Congress may adopt for the solution of the railroad problem must avoid the

"Pretty careful study of the plans proposed for, say, a dozen large companies, convinces me that—

"(a) No one of these plans can be put in operation without long, expensive and wasteful proceedings, during which honest investing interests will be exploited by speculators and manipulators to an unparalleled degree. Without attacking the motives of the proponents of these plans, I do confidently suggest that the result of the plans would be a speculative exploitation working vast and grievously unjust results.

"(b) If the plan of a dozen railroads were put into operation, problems of administration and rate-making (infinitely difficult at the best) would, in my opinion, be insoluble. Certainly, if the Warfield plan of retaining State charters were adopted, the situation would be hopeless.

"I digress to say that in the hour or two that I sat here and listened to Mr. Thom and Mr. Bledsoe I have had another illustration of the utter impossibility of the wisest set of men in the world giving any adequate transportation facilities while they operate under such law as these gentlemen are now struggling with. They can not do it. You have got to go to the roots of the difficulty. However wise and however patriotic they may be, they will fail in their attempt to give the country any honest and adequate service or to take just and reasonable care of the investors.

"(c) The notion that competition can be kept or made a force for efficiency and progress is a delusion. Even those who in their own minds advocate competition, on analysis, do not. What is really desired, for instance, by the representatives of the United States Chamber of Commerce, is not competition, but incentive for efficiency, economy, and progressive development. There ought to be such incentive. It can not, in my view, be found in the competitive theory. All of these apparent advocates of competition accept and assert that rates should be uniform. They eliminate rate cutting as a competitive factor. * * *

"A book might be written on competition and its failure in con-

rock of high freight rates or it will go to pieces. Low freight rates are a necessity in this country of vast distances. The price received by the farmer for his

nection with rail carriers. But I state, perhaps dogmatically, as my second fundamental, that we must have a unified Federal railroad company. * * *

"2. Charter a Federal railroad company, with very broad powers, including, inter alia, eminent domain to take existing transportation facilities, as well as land, etc., for additional facilities, stocks, bonds of existing companies, or any other kind of needed property; with power to issue stocks and bonds for cash at par or for exchange with present security holders; also to guarantee interest and principal of outstanding bonds. The charter should have the broadest of powers, the use of those powers being properly limited by the statute or by delegated administrative authority. * * *

"4. I think, although this is not free from doubt, that the Government should guarantee an annual dividend on this stock, possibly 4 per cent. not less than 3 per cent. Such guarantee would, in my present view, cost the Government nothing; it would stabilize the financial market, improve the credit of the company, and reduce the ultimate capital cost of our transportation facilities. * * *

"1. An offer should be made to the stockholders of the chief roads to buy their stock by exchanging stock of the United States Railroad Co. in such amounts as to give to the present stockholders a return, reckoned on the standard dividend of the new stock, not greater and perhaps, considering the greatly improved quality of their security, somewhat less, than that which has accrued to stockholders from the regular dividends paid during the period of Federal control. * * *

"At any rate, an offer should be made to existing stockholders so just and fair that the great majority of them would be glad to accept it. The rights of dissenters should be taken care of by due process of law substantially as are dissenting stockholders in the ordinary cases of consolidation. Stockholders not in receipt of regular dividends during Federal control must also have their rights determined by due process of law, perhaps in some cases by taking over the railroad property by eminent domain or awaiting the termination of valuation proceedings by the Interstate Commerce Commission before final settlement can be made. Meantime, the rights of bondholders in such companies should be fully protected, probably by continuing payments or advances as now during Federal control.

"3. The new corporation should assume, principal and interest, the outstanding bonds of the old companies, with also a provision of guaranty by the Government, excepting, of course, fraudulent or otherwise improper issues. The aggregate of such bonds is about

surplus wheat, corn, hogs and cattle is fixed by the price in Europe, where we meet the competition of the world. From that price is deducted the freight rates. If those freight rates are high, the farmer receives less; if low, the farmer receives more. If transportation rates are too high, the American farmer has no market for his surplus. Then trouble begins and hard times come.

Nevertheless, low freight rates seem to be lost sight of in Washington at the present time. The cry is "Reserves, Reserves" and yet you cannot have reserves except by high rates. The farmer is not really represented at the hearings before the Committees. He is the absent and silent witness. If he did appear he would apply this second test of low rates to each and all of the plans that have been proposed, because exports are necessary for the sale of his products and for the prosperity of the country, and to give employment to our growing population, producing more than we consume.

Then there is the manufacturer. We hear much of the great strides which we are going to make in the development of our foreign trade, and yet while we are on the threshold of that development, the very basic principle of any success in that direction is being lost sight of, namely, low freight rates. The greatest advance in foreign trade in the last century was made by Germany, and one of the principal reasons for that progress was the fixing by Germany of low freight rates

\$10,000,000,000. The average rate was recently about 4.30 per cent. It cannot yet have increased to 4.50 per cent. The assumption of these bonds, principal and interest, by the new railroad company, together with the perfectly practicable stock swapping with probably 95 per cent. of the stockholders in the regular dividend-paying roads, would eliminate all necessity of the laborious expropriation proceedings contemplated by most of the plans for reorganization and unification. This is simple mainly because it is just and will command the assent of the great majority of railroad security holders." (Record, pp. 1562-1565.)

on export goods—in fact, lower than was given on its domestic freight. The Germans saw that the problem of the freight rates was basic in their fight for the trade of the world, and for us to ignore this, in grappling with our railroad problem, will set at naught the efforts of the American farmer and the American manufacturer to get that portion of the trade of the world to which they are now aspiring.

The lowest freight rates can be obtained only by the railroad business being conducted *without profit* as well as without loss. The rates should be just enough to pay the expense of operation and a fixed income on the investment, past and future. There should be no excess profits over and above a certain dividend on the stock. The income on the investment should be fixed, and this is preferred by the conservative investor. The stock then becomes very much like a bond¹. If the income is not fixed absolutely so that the investor is safe and sure, there will be an irreconcilable conflict between rates high enough to raise fresh money, and rates low enough to satisfy the public. Nearly all of the proposed plans leave this subject of rates in the air. They speak of “fair” rates and “reasonable” rates, but they want rates high enough to produce excess profits; reserves; “shock absorbers” and money absorbers in all sorts of ways. That means high rates and high rates will produce trouble. Fresh money can be obtained without high rates, only by putting out a security that is certain

¹Edgar J. Rich, of Boston, on July 30, 1919, said to the House Committee:

“The problem, of course, is to provide service at the lowest possible cost. There is no reason why the owners of railroad securities should make any money out of the railroad. It is necessary that they should make enough money to induce them to keep the money in the railroads and to put more money in, but the return should not be more than is necessary to accomplish those purposes.” (Record, p. 367.)

and fixed as to its income, so that the investor may know exactly what he is going to get, and be sure that he is going to get it, the same as in the issue of New York State bonds and New York City bonds. A government guaranteed stock would do this, and then the rates should be high enough to pay the guaranty, and no higher. High rates are now being demanded by nearly every plan in order to be sure to have a wide margin of surplus income to tempt capital and furnish new money. Hence nearly all of these plans have surpluses above 6 per cent., with big funds for all sorts of emergencies. This is because it is feared that unless such surpluses are created fresh capital cannot be obtained. But if you remove the doubt in the investor's mind by fixing his income and guaranteeing it, you remove a dangerous uncertainty as to how high the income, and hence the rates, must be to satisfy him. In other words, instead of high rates you can get much lower rates if the investor can be satisfied, as he would be by a sure guaranty and low rate of income, thereby rendering unnecessary these vague surpluses, reserves, etc., to make him safe. If guaranteed by the Government, the Government would not lose on its guaranty because the rates would be made high enough to pay the guaranty, but the Government's responsibility would induce the investor to purchase the stocks. Excess profits should no longer have any place in the discussion of this subject. Railroad transportation should be furnished *at cost* and the elements of that cost should be made as certain as possible, especially the so-called return on the investment.

Lately the idea of any government guaranty has become unpopular. The reason probably is that the Government has made such a miserable failure in its management of the railroads that the public wishes to keep the railroads just as far away from the Government as possible. Meantime those who oppose public control

of the railroads in any form lose no occasion to say that a government guaranty will lead inevitably to government ownership.¹ That is because a deficit is feared

¹The opinion of Interstate Commerce Commissioner Clark is as follows:

"Mr. Denison: There has been some discussion, and I believe some proposal, for the Government to guarantee a return on railroad investments. That does not meet your approval or you do not think that is a wise proposition?

"Mr. Clark: I do not. I do not see how it can be divorced from the subsidy idea, and I do not believe that the time is ripe for that. I do not believe in it as a principle. If the railroads cannot be self-supporting without a Government subsidy, I think the Government should own and operate them and be responsible for all of it. To my mind it is not a sound policy for the Government to meet deficits out of the Federal Treasury which may result from errors in judgment on the part of those over whom the Government exercises no control, either as to appointment or continuance in office." (Record, p. 112.)

Mr. Warburg, at a hearing before the Committee of the House on July 23, 1919, said:

"This consideration led to the demand by some of the most prominent students of the question, for a guarantee of a minimum return to be granted by the very Government that exercises the power of regulation and of determining the return. Serious fears are, however, entertained by others lest the granting of such a guarantee might lead to incompetence on the part of the individual railroads, while, on the other hand, it is apprehended that the incurring of a direct liability on the part of the Government ultimately might lead to direct Government operation, a result abhorred by the vast majority of the people." (Record, p. 211.)

"If railroad stocks should prove incapable to attract the investor, the alternative would be a direct Government guarantee of railroad securities, which, if extended over \$18,000,000,000 of stocks and bonds, would tend most dangerously to depreciate our Government credit. It is doubted whether under present circumstances a 5 per cent, Government bond offered on so large a scale would sell at better than par, particularly if it were subject to full taxation and if every year—for additions, betterments and improvements—an additional amount approximating \$1,000,000,000 were issued.

"The Government could not to-day refund the outstanding obligations of the railroads without paying a substantially higher interest charge than the carriers pay to-day, on the outstand-

with a call on the Government to respond to its guaranty, leading to taking over the railroads; but, as explained above, the railroad rates can be varied to avoid a deficit. The United States Government lent its credit to the first railroads to the Pacific and thus enabled them to be built, and the Government was repaid practically the entire amount.¹ New York City, in building its present subways, lent its credit and obtained the necessary money on the lowest terms, and then contracted with a corporation to operate the subways for a long period of years. A guaranty by the United States Government need never be enforced, because the Government would have the power to make the rates high enough to pay the guaranty without recourse to the Government.

Another objection to a government guaranty is that

ing debt. If the Government guaranteed a certain minimum return on the stock of the new federal corporations of, let us say $4\frac{1}{2}$ per cent, the rate-making body would have to provide an adequate margin above that in order to preserve the incentive of competition, and so as to safeguard the liability incurred by the Government. In other words, if the Government guaranteed $4\frac{1}{2}$ per cent, the Interstate Commerce Commission would have to try to establish rates providing 6 per cent in order to protect the Government against all hazards. The saving to the country would, therefore, be unimportant, while the loss in the Government's credit would make itself felt all along the line.

"It is barely possible that if consolidation should not materialize on the basis of voluntary action on the part of the railroads involved, it may prove necessary to have the transportation board itself organize new holding companies, with power to acquire by condemnation proceedings the railroads to be merged into a consolidated concern, and that in order to make these mergers possible such new federal holding company would have to issue a stock endowed with a government guaranty. Let us hope, however, that such eventuality may be avoided." (Record, p. 222.)

¹See Annual Report of Commissioner of Railroads, 1903 (Interior Department), pp. 1, 12-16; also statement of the Public Dept., April, 1910; also United States Treasury Department Circular No. 62, July 1, 1908, pp. 80, 81.

it would deaden the initiative of competition. Competition itself is already deadened in the railroad business. All admit that this is so as to rates. Competition in service is now the cry, but the consolidations which all now favor would practically put an end to competition in service. Service would then settle down to good, substantial steady service; duplications of trains, especially passenger trains, eliminated; wasteful fast service cut off, and the shortest and most economical service established; common use of terminals, and sending freight by the shortest route. So-called competitive service is an unnecessary waste, and every railroad man knows it. Moreover, competition in service is between great cities and builds them up at the expense of the country. The growth of great cities at the expense of the country is a misfortune. All history teaches that.

One thing is certain, namely, that in order to raise fresh money either liberal dividends must be paid or a satisfactory fixed dividend assured. The latter would cost much less than the former, and if low freight rates are the chief consideration, a fixed dividend guaranteed by the Government will do more than a highly fluctuating and uncertain dividend.

The salability of a government guaranteed stock is certain. The rate of dividend, like interest, will be fixed in each issue. It will be fixed high enough to have the stock sell at par. Financiers have no trouble in determining the rate necessary for this purpose. Thus New York State and New York City have made repeated issues of bonds, the rate of interest in each instance depending on the market requirements. These bonds have been sold to the public and bankers at a trifle over par, it being possible to figure very closely on the necessary rate of interest for each particular issue.

There will be no permanent government guaranty at present. Public opinion is against it. But I pre-

dict that before a permanent solution of the railroad problem is reached a government guaranty will be found necessary. The argument is this. Low freight rates are necessary. They cannot be low, if high dividends and indefinite surpluses and reserves are provided for. Low rates can come only from low dividends guaranteed by the government, with an abolition of all surpluses and reserves.

I believe that a government guaranteed stock will be found necessary in order to secure low freight rates, but, nevertheless, let us test the various plans as to their effect on freight rates.

The Thomas plan proposes a fixed dividend, guaranteed by the Government, with a possible higher dividend if earned, up to 6 per cent. The possible higher dividend might well be eliminated. Government guaranteed stock could be sold sometimes on a 3 per cent. basis, but at present would have to be on a $4\frac{3}{4}$ per cent. basis in order to sell at par. With such a guaranty there would be no need of an extra dividend in order to sell the stock. All excess profits might better be abolished once for all and the rates made just high enough to pay the guaranteed dividend, and no more. Even so the rates would be high enough. Under the Thomas plan, as thus modified, the guarantee of income to investors being fixed and certain, the rates as determined by a Federal Railroad Board would not matter to the investor, because he would get his income anyway—no more and no less. Hence there would be no need of the Interstate Commerce Commission passing upon the reasonableness of the rate. The rate would be enough to pay expenses and the guaranteed dividend, in order that the Government might not be obliged to respond, except temporarily, and hence the rate would be self-adjusting. No depreciation fund would then be necessary, because re-

placements would be paid for as a part of the expenses, as formerly was the practice with all of the substantial railroads. On the other hand the Interstate Commerce Commission suspending and judicially passing upon all increases of railroad rates has been fatal in the past and would continue to be fatal in the future.

The Cummins bill directs (§6) that rates shall be fixed by the Interstate Commerce Commission, based on the interests of the public and shippers, wages of labor, cost of maintenance and operation, and requirements for new capital, any excess to be placed in the company's reserve fund and in a general fund for railroad transportations generally. All this would lead inevitably and quickly to high freight rates. Low freight rates would be impossible under the Cummins bill.

The Warfield plan is still worse. The idea of low freight rates seems never to have dawned on the Warfield people. Their idea is to put railroad rates high enough to produce a good income for present and future security holders, with a liberal margin for safety. Adopt the Warfield plan and you will have another *Munn v. Illinois*, discredited though it be. An ex-Commissioner of Wisconsin says that the commission of that state never advanced a rate without that action being immediately followed by a bill in the Wisconsin legislature to abolish the Commission.¹ The refusal of the Interstate Commerce Commission to advance rates materially was undoubtedly due to the determination of the country that freight rates shall be low, and if freight rates are advanced to keep up reserves to attract investors, as proposed by the Warfield plan, the country will not stand it.

The Warfield plan is a wonderful scheme for bracing up weak railroads at the expense of the strong ones. It would be a veritable home for incurables. It is a

¹Record, p. 1210.

high rate—weak railroad plan at the expense of the country.¹ The tried and true American railroad rule of surviv-

¹William A. Wimbish, of Atlanta, Ga., on August 5, 1919, said to the House Committee:

"The whole proposition comes down to this, that such exorbitant rates ought to be exacted from the public as would yield admittedly excessive returns to the greater number of railroads in order that the less favorably situated roads, constituting a decided minority of the whole, may enjoy a return beyond that which would inure to them under just and reasonable rates for the services rendered; and the whole public is to be enormously penalized to make up for the shortcomings of those railroads that have been unwisely built, improvidently managed, or inefficiently operated." (Record, p. 473.)

Mr. Ripley, the President of the Sante Fe, in an address delivered in Chicago in June, 1919, said as to the Warfield plan:

"The plan of Mr. Warfield also provides, not in fact, although in theory, for a guaranty of earnings; that is, the Interstate Commerce Commission shall be in full charge of rates and practically everything, including wages; that the country shall be divided into regional groups, and the rates in those groups shall be so fixed as to bring about a certain amount of revenue within those groups. This is a very devious and complicated method. I do not believe there is any possible way of providing a set of rates which will bring about such results without doing away with all uniformity and without bringing about the very discrimination which it is the desire of the country to avoid. I do not believe it is possible to make a series of rates to bring about a given result which will not result in somebody either getting too much money or too little, as the case may be. It will vary also from year to year. It seems to me the plan is objectionable in that regard."

Judging from the following, the House Committee understands the Warfield plan quite well:

"Mr. Sims: You do not feel any apprehension about us adopting any such bill, do you, Judge?

"Mr. Thom: Well, I hope not, but I hear a great deal of talk and do not know what to make of it, and consequently I am very earnest about it.

"Mr. Sims: It is well enough to be on guard, but so far as I am able to find out public sentiment throughout the country, if there is any in favor of such a proposition as that I do not know where it comes from except from those who are especially advocating that, investment bankers; that is the only way I have received any such sentiment." (Record, p. 1244.)

al of the fittest is to be discarded, and the advantage of strong railroads using all of their resources for growth thrown away. The natural absorption of weak by strong on the basis of real value, is to stop. High freight rates would prevail until the country revolted and turned to government ownership.¹

The Esch bill, as previously stated, represents the views of the Interstate Commerce Commission. That bill would not only continue the old method of commission rule;² but would enlarge it by increasing the powers of

¹Senator Cummins, in a speech in the Senate, September 2, 1919, said that unless some such plan as the one embodied in his bill "can be carried into effect, Government ownership and Government operation are but a question of time." That bill is practically the Thomas plan, if voluntary federal incorporation does not take place within seven years (Sec. 13).

Mr. Sims, formerly Chairman of the Committee of the House, said on July 24, 1919, at a meeting of the Committee:

"What I mean is that none of these temporary expedients will endure. The entire fabric of the railroad system—including the financial fabric—has been built up as a kind of patchwork, and now it has failed of its purpose, and my honest opinion is that the day will never come when conditions will not be unsatisfactory, and that this plan proposed by the executives, by your committee, and the so-called Warfield plan, all of them are merely temporary palliatives, and the time will never come, under the present system, when you will have a permanently settled condition that will last with any reasonable assurance for the future." (Record, pp. 297, 298.)

²At the hearings of the House Committee, Commissioner Clark said in regard to the proposal that the Commission in fixing rates shall consider the cost of labor and other operating costs: "In actual practice it will not change the rule followed by the Commission, because the Commission has recognized that the necessary operating costs inevitably affect the net return and that the net return under reasonable rates and proper management is what the carrier should have in proper measure and is the only thing that the carrier has upon which to live, beyond the mere operation of the property." Mr. Clark said the Commission also considered the return on capital (Record, p. 36). Mr. Clark further said: "In some of these measures it is proposed that the Commission shall be affirmatively charged with the duty of establishing rates which shall produce a given percentage in each rate district of net earning as compared with the book cost

the Commission and giving it more absolute control over rates. There is no inclination by the Commission to try any new plan.¹ It is difficult to believe that any ar-

or investment cost, as it is called, of the railroads in that district, in the aggregate. This would be to put upon the Commission the impossible. No man can figure out a level of rates which for the next year will produce closely a certain percentage on a given sum of money." (p. 39.)

¹The following are Interstate Commerce Commissioner Clark's views on this subject:

"Mr. Rayburn: Mr. Clark, I gather from your statement and from your answers to inquiries that you believe the transportation question in this country can be met and solved by amendments to the interstate commerce act as it now stands rather than by uprooting all lines along which we have tried to travel for at least since 1887 down to now and the substitution for it of some wholly new scheme for the control and regulation of the railroads.

"Mr. Clark: I think that so far as we pursue the governmental policy of privately owned railroads subject to governmental regulation, it is better to round out a system that we have tried and that has been tested by experience and in the courts rather than to supplant it with some entirely new and untried scheme. * * *

"Mr. Clark: I believe firmly in carrying out the principle of consolidation and merger of railroads into larger systems, in so far as that can appropriately be done with proper consideration for the public interest, and that it ought to be done under governmental supervision and control. I do not think that it would be desirable to zone the country and put into the possession of one corporation or one railroad company all of the railroads in that zone, regardless of the trend of the traffic which they move. As I said in answer to the chairman the other day, I would not think of consolidating into one system in a particular zone those lines that handle traffic that naturally and must always trend in a north and south direction with those that handle traffic that moves east and west. It is a different traffic, but it meets with some competition. I think that to block the country out and to put all the railroad traffic in that block in the hands of one corporation would lead to stagnation and would effectually eliminate any semblance of competition. * * *

"Mr. Rayburn: Do you believe that federal incorporation would tend toward the solution of the railroad situation?

rangement of this kind would work out a permanent solution. The rates would be too low, as of old, to keep the railroads solvent and raise fresh money, or they would be too high to satisfy the public. There would be no stable rule to govern them. It would depend largely upon the peculiarities, idiosyncrasies and intellectual processes of the personnel of the Commission itself. That will never solve the railroad problem.

The Plumb bill would quickly make freight rates so high that interstate and international commerce would largely disappear. But there is no occasion for discussing the Plumb plan; it has eliminated itself.

The Lenroot plan prescribes (§30) that rates shall be sufficient to pay operating expenses, depreciation, maintenance, interest and maximum dividends and 2 per cent. additional, any surplus to be subject to lower rates, except that such 2 per cent. of the surplus shall be given 40 per cent. to labor, 30 per cent. to the stockholders and 30 per cent. to repay any advances from the Government or for a reserve fund or to retire stocks or bonds or for improvements (§31). This does not hold out any brilliant prospect of low freight rates. On the contrary, it means as high freight rates as the public can bear or will stand.

The Railroad Presidents' plan does not hesitate to call for rates sufficient to pay expenses, interest, dividends, depreciation, reserves, and enough to enable the railroads to raise fresh money. Whether they could at the same time give low railroad rates would, of course, depend upon all of these elements. There can be no doubt that the railroads have given extraordinarily low

"Mr. Clark: I have not been able to see the necessity for it. As I said the other day, I think, to the chairman, the power of Congress is plenary, and it does not make any difference who owns the property that is regulated, or under what franchise it is operated." (Record, pp. 121, 122.)

freight rates in the past; the lowest in the world, distances considered—lowest in the world because (1) there was competition in rates, now no longer possible; (2) a relentless policy of promoting the ablest operating men from the staff—still possible; (3) liberal salaries—also still possible. Wall Street control at least did that, and Wall Street, in making money out of the railroads, made it out of investors—not out of the public by high railroad rates. However, Wall Street control has gone, never to return.

In conclusion, one comfort the investors have; they must be protected as to the past and future, to induce them to invest one billion dollars a year fresh money in the railroads, as is absolutely necessary. Stocks and bonds representing nothing will be eliminated, but real values will be protected. And the interest and dividends on them will have to be high, unless there is a government guaranty. In either case the investor will be protected because he has to be sought for. He is not particularly interested in high rates or low rates, so long as he gets his interest and dividends. His confidence will be the turning point finally of the whole controversy. In other words, the necessity for obtaining fresh money in large amounts insures fair treatment of present railroad bonds and stocks. It will come about by the very necessities of the situation. Meantime, this is consistent with the idea that the railroads shall be operated *without profit and without loss*—good service at the lowest cost—and this can be accomplished by public control and a public guarantee only.

And there is another gleam of light comforting to railroad investors. The Thomas plan provides for their exchanging their securities for government guaranteed stock on fair terms.¹

¹In such an exchange of outstanding stocks and bonds for new stock in the new federal corporations the investor could be and would

All of the other plans, which lead to a permanent solution of the railroad problem have adopted the Thomas plan in all fundamental respects. The Cummins plan, the Lenroot plan, and the Frelinghuysen plan, follow it. As pointed out in my pamphlet of June 9, 1919, Mr. Hines, Mr. Sisson, Mr. Dunn, Mr. Taft and Mr. Morawetz have all adopted the same idea. On the other hand, the Plumb plan and the Warfield plan are revolutionary; the Railroad Presidents' plan reactionary; the Esch plan stationary. The Esch plan is plainly a temporary expedient. Even the railroad presidents seem to be seeing the light. Mr. Trumbull, the former Chairman of the Railway Executives Association, issued a pamphlet September 10th, 1919, adopting unqualifiedly all the essentials of the Thomas plan. This signifies much and extracts from his pamphlet are given in the note on the next page. It shows that public sentiment is focusing rapidly in favor of the Thomas plan. In fact that is the only creative plan that has been presented, and is

be treated fairly as to the value of his holdings of present outstanding stocks and bonds. The earning power would be considered. Physical valuation would not control. Judge Lovett was right when he said "I do not see that there will be much practical value in the valuation. I do not think that it will help." (Record, p. 1336.) Judge Anderson expressed the same view when he said "that valuation theories applied to railroad property are exceedingly dangerous to the general public." (Record, p. 1574.)

Mr. Warburg, at a hearing before the Committee of the House on July 23, 1919, said:

"The conference understands that it is the purpose of the Interstate Commerce Commission in the near future to define what principles it will apply in establishing the value of a railroad as a whole. It is believed that such definition will provide that a consideration of the average earning power of a railroad, for a given period of years, should be given at least the same weight as the physical value of a railroad, and that the Commission's definition will take into account such other elements as may be proper in determining fair value, leaving room for adjustments in individual cases." (Record, p. 209.)

bound to prevail. It is clear, in the opinion of all of the real thinkers on this subject, that the only way out is to cut the Gordian knot by having a federal corporation or several federal corporations acquire once for all the stocks and bonds of the existing railroad companies, and thus control them absolutely and weld them into a comprehensive public system. The Thomas bill will do this.

New York, November 24th, 1919.

WILLIAM W. COOK.

EXTRACTS FROM MR. TRUMBULL'S PAMPHLET, REFERRED TO ON
PAGE 32 ABOVE.

"It seems to me that there can be no consistent treatment of the subject as a national question, except through combinations of the financial structure of the railroads, in a limited number of competitive groups. The easy and simple way to accomplish this would be, to my mind, not through compulsory federal incorporation of existing companies (particularly as the very divergent opinion of eminent lawyers as to the legality of this course inevitably would involve the whole subject in litigation) but through the organization of new competitive federal corporations to take over the stocks—but not the bonds, except in some special cases—of the existing companies. * * * The stockholders of any existing company will naturally ask: 'What will we get in exchange for our present holdings?' The Government should, in my judgment, guarantee dividends upon the stock of each of these new corporations upon a basis which would sell the new stocks at par, at the time of issue. If the Government is to give, by statute, an assurance of adequate rates a specific guarantee will cost it nothing. These new stocks, being guaranteed by the Government, would afford what may be called a gold basis of exchange. The shareholder in the prosperous road should get say \$125. per share, \$150. or whatever the fair value might be; and the shareholder in the weak road should get his fair value—\$50. or \$60. or less or more according to its merits. The guarantee feature would obviate much discussion about relative values of the different roads, which would be necessary under any other consolidation plan. What the rate of guarantee would be, could be determined by a Federal Transportation Board. * It is said, and I agree, that shareholders cannot be compelled to accept anything but cash. But a Federal Transportation Board might be empowered to make, after impartial study and investigation, contingent agreements with or offers to shareholders of the different roads, to be accepted or rejected, say within one year, and at the end of that time could decide whether there had been sufficient acceptances to justify the Board in going ahead and closing up the program. Then if they decide to go ahead, the remaining outstanding stock could, if necessary, be condemned, and if any old holder would not accept the new stock in lieu of cash, the necessary new stock could be sold to the public and the proceeds used to pay him out. The cash required would thus be minimized; * * * The investor who would be invited to exchange the old stock for the new guaranteed stock would naturally have to think of *the alternative*, that is to say, what will become of his values *under uncertain regulations*, dependent upon fluctuations of traffic, and in operating costs, bearing in mind also

the drift of legislation, and the possible outcome for his particular company, of the valuations now proceeding, and of the unprecedented litigation which those valuations must unavoidably entail. I believe that such an offering could be made a great success within a year of the date of the offer. There would be a minimum disturbance of existing security issues—certainly much less than will occur under a policy relying upon ‘adequate’ regulation. It is possible that some of the more speculative or precarious bonds (income bonds more particularly) ought to be treated in the same way as stock. Special provision could, if it were thought fit, be made for this by giving discretionary powers to a Federal Transportation Board to deal with these securities, in connection with the acquisition of the stocks of the companies which have issued them. * * * New federal corporations not less than twelve nor more than eighteen in number to be organized by the Federal Transportation Board. These corporations to be empowered to issue stock or obligations of existing companies. Titles to the properties themselves could be taken later, if desirable, subject to debt then outstanding. The Federal Transportation Board to determine the grouping of roads into twelve, or not more than eighteen *competitive* systems. Stocks of existing companies to be acquired by these new companies—observing allotment of existing lines to the new companies as decided upon by the Federal Transportation Board. Acquisitions to be made upon the basis of fair value of the stocks—net corporate income for a test period to be prominent factor. * * * As private investors are asked to contribute capital, either as now existent, or for new purposes, the Government should contribute security, particularly as the Government has complete control over revenue and in the public interest is taking more and more control over operations. The Government should have responsibility as well as power. It should for the public welfare, get ‘under’ the railroads as well as over them. The Government would have to furnish money if private investors do not. The stocks of the new corporations should therefore be guaranteed by the Government, the rate of guarantee to be such as will sell the new stocks at par at time of issue. * * * Some companies may claim current physical value of property devoted to the public service, less debt assumed by the new corporations. Market prices of stocks would not afford a fair criterion of the value of *all the stock* of a given company. Manifestly no owner can get all three values, namely; earnings value, current physical value and market quotation. So the Federal Transportation Board should have broad powers of negotiation, and there should be complete publicity of its conclusions. Conservative dividends actually paid during a test period should also be considered, in fixing the exchange between the new stock at par, and the old. It would be a serious matter to diminish individual incomes. On the other hand investors who have had no dividends, ought not to be penalized for putting their earnings

at the disposal of the public. Manifestly dividends must be higher than six per cent. per annum, if existing companies are to be employed to do the transportation business of the United States. The country therefore can well afford to be not only fair, but generous to all who have put actual values at its service, and thus gird up its loins for enormous expansion of commerce, and greater service to the world."